National Credit Union Administration
Board Member Deborah Matz

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Challenges & Opportunities

Thank you Paul for your very kind introduction. I'd also like to thank Susan Newton for inviting me back to speak with you.

When I spoke at the last AACUL Winter Meeting, I don't think many of us anticipated what a difficult year it was going to be. Looking into my crystal ball, I don't think this year is going to be any easier.

In addition to the new taxation threats, which I know you're all too well aware of, I see two other major challenges on the horizon:

- the continuing disappearance of small credit unions,
- and the need for credit unions to manage interest-rate risk.

I believe all three of these challenges present tremendous opportunities for leagues. With your outstanding leadership, leagues are perfectly poised to guide credit unions through these difficult times and help determine the destiny of credit unions.

My speech last winter recognized a number of league initiatives intended to help credit unions grow. Many of you approached me afterward and said it was very helpful to learn what other leagues were doing.

So today I plan to share some of the latest league initiatives with you. In my travels over the past year, I have seen many new ways that leagues are helping credit unions.

But this year I think it's important to put these league initiatives in a different context: I firmly believe that by helping credit unions reach more people in their field of membership, these initiatives can also help prevent credit unions from being taxed.

Taxation

From my perspective as a regulator, maintaining credit unions' tax exemption is critical to protecting safety and soundness. If credit unions are taxed, the taxes will cut into retained earnings. Even credit unions that are healthy today, under that scenario, could face Prompt Corrective Action.

In addition, without any other source of capital, if credit unions are taxed, they would probably not have the net worth to offer needed new services or to branch out into underserved areas. Thus, credit unions would be unable to serve the very people who need them the most.

But I also try to look at the tax issue through the eyes of a lawmaker:

Many lawmakers perceive that credit unions' cooperative structure is one reason for the tax exemption – but they know it is not the only reason.

These lawmakers are quick to point out that several other co-ops are taxed. In fact, some co-ops are taxed according to the services they provide and the people who receive those services.

Therefore, lawmakers may ask, "Why shouldn't credit unions be taxed?"

From a public policy standpoint, lawmakers weigh any group's tax exemption against the public good.
Many lawmakers hold the perception that credit unions exist to serve the public good by filling a void left by other financial institutions. These lawmakers want to know what credit unions are doing to help their constituents.

Reaching Out to Everyone in the FOM

When credit unions reach out to everyone in their field of membership – including new immigrants, students, members of the military, single mothers, small business owners, senior citizens, renters, and other people with low-to-moderate incomes – they give lawmakers more reasons to preserve their tax exemption.

I always tell credit unions that there are many ways to reach these diverse groups. And if they can't figure out how, they should ask their leagues for help.

Today I'm going to focus on ways that leagues can help credit unions serve more people. I'll highlight four innovative services that can help credit unions reach more people in their current field of membership. And I'll cover two key requirements for charter conversions that allow credit unions to expand their field of membership.

First let's focus on the four services.

In my conversations with credit union officials, and judging from the growing participation at my PALS workshops, it is clear that more credit unions are looking for ways to offer new services. I hope that more leagues will encourage them to offer alternatives to predatory lending, affordable mortgages for first-time homebuyers, financial literacy programs, or member business loans.

Last year I emphasized how these services are not just the right thing to do; they're good business.

This year I believe these services are even more important to credit unions' bottom line. I believe they are the best defense against taxation. When these services reach people who are not served by other insured institutions, they can convince lawmakers that credit unions deserve to keep their tax exemption.

1) Alternatives to Predatory Lending

Small Loans

For some people, the most critical service credit unions can provide is an alternative to payday lenders and pawnshops.

Hard-working people who need $200 to fix a car or $300 for a medical emergency frequently find financial institutions off limits. Banks simply don't make such small loans.

When leagues encourage credit unions to make these loans, they are not only helping victims of payday lenders. They are helping credit unions justify their tax exemption.

Michigan & Florida

The Florida and Michigan leagues have gone even further. They worked hard to get bills passed in their states to give consumers access to more affordable payday lending alternatives.

Here in Florida, the league has been working with the state CFO to present "Consumer Outreach Forums." The forums explain Florida's new law, which protects consumers from having more than one payday loan at a time and caps short-term interest rates at 10% on small loans.

Although Michigan's payday lending bill was ultimately vetoed, legislative efforts such as these help improve public officials' perceptions of credit unions, by associating credit unions with pro-consumer efforts.

Risk-Based Loans

Leagues can also encourage credit unions to structure larger loans that provide alternatives to title companies, rent-to-own stores, and other predatory lenders who charge usurious rates and fees for big-ticket items.

By advocating risk-based lending, you can inspire credit unions to provide reasonably priced loans of almost any size to almost any borrower.

Even if credit unions' risk-based loans carry interest rates of 10 or even 18%, they are much more affordable than predatory lenders.

In the past year I have heard from more and more credit unions that are reaching out to everyone in their field of membership through risk-based lending.

By finding ways to approve loans for almost all borrowers, some credit unions have raised their loan approval rates to over 80%!

Unfortunately, there are still many well-meaning credit union leaders who resist risk-based lending for philosophical reasons. They believe that the credit union philosophy requires all members to be treated alike.

However, you can point out that when credit unions do not offer risk-based loans and instead turn away C and D borrowers, they are not treating all members alike. They are leaving higher-risk borrowers no choice but to turn to predatory lenders.

When you talk with your members, please assure them: Risk-based lending is consistent with the credit union philosophy.

Risk-based lending is an opportunity for credit unions to gain loyal members by ensuring that just about everyone has access to a loan at a price based on their personal credit history.

2) Affordable Mortgages

The next step up for these members may be a loan to purchase their first home. But while 67% of credit unions make mortgages, only 2% of all mortgages are made by credit unions. That means the vast majority of credit union members are going elsewhere for their mortgages.

That translates into tremendous opportunities to reach out to current and potential members who do not yet own a home -- particularly minority households. Only 48% of Black and 44% of Hispanic households own homes, compared to 68% of all households.

New York

Leagues can help reach more potential homebuyers. In New York, for example, the league conducts first-time homebuying seminars throughout the state. To give renters an opportunity to buy their first home through a credit union, the league's mortgage company helps credit unions offer a wide variety of affordable mortgages. These innovative mortgages allow renters to buy their first homes with as little as 3% out-of-pocket funds.

Of course, not every league can start its own mortgage company. But all of you can help credit unions reach the people who are most in need of affordable mortgages, by making them aware of potential housing partners in your state.

NeighborWorks

Many potential partners belong to the NeighborWorks network – affiliates of the Neighborhood Reinvestment Corporation, or NRC. As NCUA's representative on the NRC Board, one of my challenges is to help raise awareness of the NeighborWorks network among credit unions.

NeighborWorks organizations operate much like credit unions: All are non-profit, governed by volunteer boards, and provide needed services to well-defined populations.

Yet banks more frequently have relationships with NeighborWorks organizations than credit unions do.

I feel confident that if more credit union leaders were aware of the benefits that NeighborWorks organizations could provide for their credit union, their members and potential members, they would be eager to explore partnership opportunities.

New Hampshire

That was exactly what happened in New Hampshire.
It began after Dan Egan and I co-hosted a workshop to encourage credit unions to partner with NeighborWorks organizations.

Under Dan's leadership, the New Hampshire League put together a statewide partnership with the Neighborhood Housing Services of Manchester that could serve as a model for other states. Together all 32 New Hampshire credit unions pledged $35 million to establish a fund for two affordable housing programs to be administered by this NeighborWorks organization.

The first program benefits first-time homebuyers who do not qualify for a conventional mortgage. The second program helps families in crisis make critical payments for essential services such as home heating and electric bills.

Both programs also provide free NeighborWorks counseling, which helps new homeowners manage their properties and their finances to become more stable credit union members.

For more information about NeighborWorks organizations, I encourage you to read this free publication. Copies are available on your tables.

Not all partnerships have to be with NeighborWorks, however. There are literally dozens of potential housing partners credit unions can work with – local government agencies, federal agencies, and consumer organizations, to name a few.

Just imagine: If 32 credit unions in New Hampshire raised $35 million, what you can do in your state! I challenge each of you to take Dan's lead and establish an affordable housing initiative in your own state.

3) Financial Literacy

You may already be undertaking another initiative that goes hand-in-hand with first-time homebuying: financial literacy. As you know, before renters can safely buy a home, they should have the financial literacy skills to keep their home.

I know that just about every league encourages credit unions to offer financial literacy programs. And credit union financial literacy programs are world class.

Across the country, educational materials prepared by leagues are vital in helping credit union volunteers teach financial literacy in virtually any venue: schools, military bases, community centers, homeless shelters, and in just about any place where people can meet.

Idaho

The Idaho League has even found a way to reach migrant workers, by partnering with the state Migrant Council to teach migrants how to save on international remittances.

New York

And the New York League helped author a new law that allows credit unions to open branches in schools that are not in their field of membership. Now that's outreach!

Adapting National Financial Literacy Programs

There are so many innovative financial literacy programs available through leagues. I'm going to quickly touch on three of the most recent initiatives that could be adapted in your states:

California

I know that most of your leagues support the High School Financial Planning Program underwritten by CUNA and the National Endowment for Financial Education (or NEFE).

However, I understand that your challenge is to get the NEFE program into the curriculum of more high schools.

The California League recently completed an initiative to do just that. The League provided a grant to a group of educators to develop a publication that shows teachers how the NEFE program meets the state's high school standards.

Like many states, California has mandated that teachers use a standards-based curriculum, geared toward higher test scores. So linking the NEFE program to those standards is a way to provide incentives for teachers to promote the NEFE program in their classrooms.

Louisiana

Louisiana went a step further. The league successfully supported legislation that will require high schools to teach money management, and will provide teachers with free NEFE training.

Ohio

Seizing on another national initiative, the Ohio League will sponsor Consumer Protection Week during the week of February 2. Other states can do this, as part of the Federal Trade Commission's National Consumer Protection Week program. The theme of this year's program is "Financial Literacy." So in partnership with the state attorney general's office and the state Consumers Council, the Ohio League is encouraging all of its credit unions to plan financial literacy events.

4) Member Business Lending

At the beginning of my speech, I mentioned four services that can help credit unions reach everyone in their field of membership – and help prevent taxation.

The first three services – predatory lending alternatives, affordable mortgages, and financial literacy – are all aimed at people with relatively lower incomes.

My fourth suggestion – member business lending – may also have a low-income focus.

You may be surprised to learn, as I was, that nearly half of credit unions' business loans go to members with low-to-moderate incomes:

- More than 25% of credit unions' business loans go to members with household incomes under $30,000.
- Another 20% go to members with household incomes from $30,000 to $50,000.

So while it may sound strange at first, business lending is another way to reach people of all income levels who are underserved.

Credit unions' average business loan is just $118,000. Banks generally won't make these loans because they are too small. Today, more than 70% of banks' business loans are over $1 million.

Serving the small business niche presents a large opportunity for credit unions. Yet I understand that many credit unions cannot generate enough business loan volume on their own to hire a full-time, in-house business loan officer.

So I am very encouraged to see leagues working to facilitate cooperative efforts that will help credit unions provide this needed service.

Pennsylvania

For example, the Pennsylvania league created a CUSO that offers business lending experience and technology that most credit unions could not afford alone. The CUSO also facilitates business loan participations, which enable more credit unions to invest in small businesses.

In 20 other markets around the country, individual credit unions have banded together to form similar business lending CUSOs. Many, like the new CUSO formed by seven credit unions in Ohio, were organized with support from their league.

FOM Conversion Assistance

So far today I have shared league initiatives that help credit unions provide new services to everyone in their field of membership. Now with NCUA's new field of membership regulation, you also have new opportunities to help credit unions expand their field of membership.

The regulation presumes that any single jurisdiction is a well-defined community. In addition, multiple counties up to 500,000 people and metro areas up to 1 million people are now also considered "well-defined communities" for chartering purposes. Therefore, these applications can be approved by NCUA's regional offices. Larger communities may also be approved, but they must be considered by the NCUA Board.

Regardless of the size, before any community charter can be approved, the credit union must show an ability and a commitment to serve everyone in the community. These requirements can be fulfilled in two sections of the application:

- The Business Plan must demonstrate the ability to provide community-wide branch access, as well as low-cost services to attract underserved groups.
- The Marketing Plan must demonstrate a commitment to reaching more potential members – including, and perhaps especially, the underserved – through strategic advertising and community outreach.

Some credit unions are having a difficult time meeting these requirements. But it is not difficult. I assume they are simply unaware of what is required.

Leagues could be instrumental in providing information and training to credit unions about our FOM regulation -- particularly about the Business and Marketing Plan requirements.

This regulation was approved to help credit unions diversify their membership, which can be essential to safety and soundness.

However, the Board's support for this regulation does not mean we are turning our backs on small credit unions.

Small Credit Unions

This brings us to the second major challenge facing us in 2004: the disappearance of small credit unions.

In the past two years we have lost over 600 small credit unions.

This is a concern for many reasons. Small credit unions tend to serve niche markets, offer exceptional personal service, and in many areas are the only insured financial institutions in their communities. So when some lawmakers hear "credit unions", they visualize small credit unions. To these lawmakers, small credit unions are the icons of the credit union system – and justification for the tax exemption.

So there is more at stake than just small credit unions. If their disappearance leads to taxation, what's at stake is the safety and soundness of the entire credit union system.

However, I don't believe we should keep small credit unions on life support if they are unable to meet their members' needs. I believe we should help the small credit unions that are thriving so they can continue to serve a unique niche with a personal touch.

Yet NCUA's regulatory framework may include policies and procedures that unduly – and unintentionally – burden small credit unions.

That's why I formed a Small Credit Union Working Group within NCUA. This group is examining how NCUA can help small credit unions reach their full potential.

I believe that within the bounds of safety and soundness, there are changes we can make to help small credit unions flourish.

Our working group is evaluating literally thousands of ideas received from credit union leaders, trade association officials, and NCUA staff. We expect to issue a list of recommendations later this year.

I should point out that these recommendations will focus exclusively on NCUA. We are not making recommendations about leagues or other organizations.

But it is clear that small credit unions depend on leagues to provide vital support.

There are so many areas where small credit unions can benefit from external assistance. For example: help with back office tasks and compliance; donations of computers and other equipment; I.T. expertise; training, grants and scholarships; mentoring…

The list goes on and on. In fact, the list can be overwhelming. When the AACUL staff shared their small credit union survey with me, I was amazed to see more than 20 different types of assistance that small credit unions have received from their leagues. And I was impressed that 38 leagues offer an average of nearly 10 small credit union programs per league.

But there are many other valuable programs that were not included in the survey. You can talk to Gene Poitras for innovative suggestions. In addition to providing 13 programs listed on the survey, Gene's Small Credit Union Committee in Oregon has developed a statewide vendor directory and a low-cost legal retainer for small credit unions.

Such programs may not be as costly as you might think. I was interested to see some smaller and mid-sized leagues among the leaders in offering small credit union programs. For example, North Carolina leads the way with 16 small credit union programs. Iowa, New Jersey, and Texas have 15, and Tennessee has 14.

In fact, the costs may be outweighed by the tremendous benefits of having healthy small credit unions that can help uphold the good reputation of the entire credit union system.

Interest-Rate Risk

The third major challenge on the horizon in 2004 is managing interest-rate risk. While there are many types of risk that can lead to PCA sanctions, this year, interest rates pose the greatest threat.

Rates are still relatively low, but forecasters warn that rates could soon become much more volatile.

Already, there is a dangerous imbalance on some credit union balance sheets: High concentrations of long-term mortgages, with low fixed rates, are being funded by short-term deposits with variable rates.

Today, mortgages earning 5% afford higher returns than short-term investments. But, will that be true a year from now? Your guess is as good as mine.

One thing is certain: Interest rates are going to rise. How far and how fast rates rise could determine the fate of many credit unions.

Credit unions today have an astounding 44% of their loan portfolios in mortgages. If rates rise slowly and steadily, credit unions will be able to adjust their portfolios safely.

But, for example, if rates rise 200 basis points over the next year – which is not unrealistic – some credit unions could be shut out of the secondary market.

If credit unions are holding too many fixed-rate mortgages when rates rise, the flow of higher earnings will soon evaporate. Then those credit unions would lose liquidity if they cannot meet members' demands for higher dividends.

Under this scenario, credit unions with high mortgage concentrations would have no choice but to merge into larger institutions when rates rise.

This unfortunate situation can be prevented, however -- if credit unions act quickly. To provide guidance to credit
unions, NCUA on September 24 released a Letter to Credit Unions on managing real estate risk.

The letter contains detailed guidance on what credit unions should be looking for – and what examiners are now looking for – to safely position portfolios for the upcoming rate hikes.

Please make every effort to ensure that your members have read this letter and are preparing themselves.

I know this is not an easy sell. You may hear two concerns (as I have) from well-meaning credit union leaders:

At first they may tell you that they don't want to give up relationships with their members. But you can show them how to retain the servicing on all mortgages they sell.

Then they may tell you that they don't want to sell their fixed-rate mortgages because these are their highest-earning assets right now. But you can point out that examiners would rather see lower earnings today to avoid higher risks tomorrow.

PALS

In my last few minutes with you today, I'd like to update you and thank you for working with me on the initiative that I call PALS – Partnering and Leadership Successes.

As most of you know, I launched PALS last February at CUNA's GAC. I recognized that leagues were helping credit unions enhance their services and

attract new members in their states, and I designed PALS to share ideas by providing networking opportunities across state lines.

In our first year, 12 leagues will have co-hosted PALS workshops to share credit unions' best practices around the country. Workshops so far have focused on innovative ways to forge affordable housing partnerships, connect with Latinos, and safely make more member business loans.

PALS CDs

Presentations from the two most recent PALS workshops are now packaged together on a free CD. We put one CD in each of your folders. If you could use more, just let me know.

Each time we hold a new PALS workshop, we will add the new presentations and package all of the workshops onto a new CD.

Predatory Lending Alternatives (Dallas)

I am really excited about the three PALS workshops we have scheduled so far this year. I invite all of you and your key staff to attend, so you in turn can train credit unions throughout your states.

This coming Monday in Dallas, the next PALS workshop will provide alternatives to predatory lending. It will be co-hosted by the Texas League and the Texas Foundation, with participation from the Arkansas, Louisiana, New Mexico, and Oklahoma leagues.

We have put together a dynamic lineup of credit union speakers to share more innovative services that can prevent members from being victimized by predatory lenders.

I am very pleased that Chairman Dollar will be delivering a special keynote address.

I'd like to take this opportunity to thank Chairman Dollar for all the support he has provided to PALS.

His support along with the leagues is a major reason why we have become so successful in attracting credit union officials to these workshops.

MBL (San Francisco)

Vice Chair Johnson and I plan to hold a second member business lending workshop for those who could not attend last year's MBL workshop in D.C.

On March 25 in San Francisco, this workshop will provide another opportunity to learn about the key changes in our regulation and see how credit unions put together sound business lending programs.

Co-hosts will be the California, Nevada, Oregon and Washington leagues.

How to Make More Mortgages (Boston)

The third PALS workshop of the New Year will focus on "How to Make More Mortgages." Speakers will share ideas on how to build higher mortgage volumes while managing the interest-rate risks.

We haven't announced this yet, but the mortgage workshop will be held on June 2 in Boston and will be co-hosted by the Massachusetts, New Hampshire, Rhode Island, and New York leagues.

The Future

Several of you have already offered great ideas for future PALS workshop topics and locations.

I don't know exactly what the future will bring us, but I am optimistic about the future of the credit union system.

Through the years, league presidents have shown an extraordinary ability and commitment to lead credit unions. I believe that league presidents have their fingers on the pulse of the credit union movement, and that your leadership and dedication will inspire credit unions to diversify their membership, effectively manage their risks, and serve more people with affordable products.

Thank you again for inviting me back to speak with you. I look forward to working with you to meet the challenges ahead.